No. 80-1182

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

ROBERT W. MESERVE and BENJAMIN H. LACY,
REORGANIZATION TRUSTEES OF THE
BOSTON AND MAINE CORPORATION, DEBTOR, and
THE FIRST NATIONAL BANK OF BOSTON and
MALCOLM W. HALL,
SUCCESSOR INDENTURE TRUSTEES,

Petitioners

v.

CHESAPEAKE AND OHIO RAILWAY COMPANY,
MAINE CENTRAL RAILROAD COMPANY,
PENN CENTRAL CORPORATION,
CANADIAN PACIFIC, and
EASTERN ASSOCIATED COAL CORPORATION,
ET AL.,

Respondents

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

BRIEF IN OPPOSITION FOR RESPONDENTS MAINE CENTRAL RAILROAD COMPANY AND PORTLAND TERMINAL COMPANY

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QUESTIONS PRESENTED

1. Did the United States Court of Appeals for the First Circuit err in granting priority, on the basis of equitable principles recognized by this Court, to claims of connecting carriers and others arising out of the provision of necessary goods and services to the debtor railroad during the six months prior to the commencement of this reorganization proceeding?

2. If the Court of Appeals erred in rejecting the requirement of a "current expense fund" as a prerequisite to a priority classification for "Six Months" claims, should depreciation, a non-cash item, be deducted from revenues in determining the existence of a current expense fund with which to pay claims of Six Months creditors?

PARTIES

Petitioners and respondents are identified in the Petition.

This Brief is submitted on behalf of respondents Maine Central Railroad Company and Portland Terminal Company. The latter is a wholly-owned subsidiary of the former, which, in turn, is a subsidiary, through wholly-owned subsidiaries, of United States Filter Corporation. United States Filter Corporation owns approximately 20% of the voting stock of Koehring Company.

Ashland Oil, Inc., through a wholly-owned subsidiary, owns 92.8% of the common, and 60.6% of the voting, stock of United States Filter Corporation. William L. Cary, as Trustee for Friedrich Flick Industrieverwalting, KGaA holds 100% of the Series A stock (approximately 35% of the voting stock) of United States Filter Corporation. Non-wholly-owned subsidiaries or affiliates of Ashland Oil, Inc. have not been listed here, but will be provided if desired.

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STATEMENT OF THE CASE

On March 12, 1970, an involuntary petition for reorganization was filed against the Boston and Maine Corporation ("B & M") in the United States District Court for the District of Massachusetts pursuant to Section 77 of the Bankruptcy Act, 11 U.S.C. § 205. The District Court approved the petition and appointed Reorganization Trustees.

The respondents Maine Central Railroad Company ("Maine Central") and Portland Terminal Company ("Portland Terminal") are connecting railroads, or "interline carriers", which have furnished necessary goods and services to the B & M, largely pursuant to statute or Interstate Commerce Commission mandate. App. A-3; C-5.[1] Such claims, including claims for per diem car hire, freight loss and damage and overcharge, car repairs, and diesel fuel, routinely had been paid prior to the bankruptcy under railroad accounting practice and rules, and have been paid during the bankruptcy as expenses of administration. App. C-10-11. Claims unpaid on the date of bankruptcy, however, were rejected, and the Maine Central and Portland Terminal claimed an absolute priority with respect thereto under the so-called Six Months Rule. App. A-3.[2] The Six

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[1] References prefixed "Pet." are to the Petition for Certiorari, while "App." refers to the Appendix to said Petition.

[2] Although the petitioners assert that it is generally agreed that such claims rank junior to post-petition administration claims, it certainly is not so agreed by Maine Central and Portland Terminal. On the contrary, such claims are entitled to an absolute priority, and the First Circuit by its reversal obviously endorsed the contention that such claims are entitled to such priority as will assure full payment. App. A-3, A-46. See Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. 93-137, 93rd Cong., 1st Sess., Part I, p. 270 (1973) (the Rule accords Six Months creditors "the status of administrative expense claimants").

Months Rule is inherited from equity receivership, and entitles a claimant to priority for claims arising out of the provision of necessary goods and services to a railroad during the six months prior to bankruptcy.

The Reorganization Trustees filed a Plan of Reorganization in December 1975, which contained a proposed classification of creditors which would have rejected the priority sought by Six Months Rule claimants and relegated such claims to ninth place along with general unsecured claims. When the Trustees in 1977 sought approval of their proposed classification, the District Court agreed. App. B. The claims total, according to the Reorganization Trustees, approximately $3,000,000. App. A-11; C-4.[3]

The District Court endorsed the Trustees' wooden, mechanistic approach to the Six Months claims, and refused to grant a priority on the ground that there was no "current expense fund", *i.e.*, net earnings, from which to pay such claims. In making this determination, the District Court held that depreciation, a non-cash item, should be subtracted from revenues. *In re Boston and Maine Corp.*, 486 F.Supp. 996 (D. Mass. 1979); App. B.

The First Circuit reversed insofar as the lower court's order failed to provide for a separate class of Six Months creditors entitled to priority. In an extended, comprehen-

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[3] Four days after the District Court rejected the interline carriers' assertion of priority with respect to these claims for necessary goods and services, it authorized the Trustees, over respondents' objection, to draw down approximately $33,000,000 in cash to make an immediate tender offer to the First Mortgage bondholders, even though a final Plan of Reorganization had not been approved. The District Court also ordered the Trustees to reserve $3,000,000 against the Six Months claims. In re Boston and Maine Corp., 468 F.Supp. 996 (D. Mass. 1979); In re Boston and Maine Corp., 468 F.Supp. 1010 (D. Mass. 1979).

sive and scholarly analysis, the Court of Appeals found two separate and distinct principles upon which to accord a priority to Six Months creditors.

First, it held that *Fosdick* v. *Schall,* 99 U.S. 235 (1878) recognized a principle, derived from mortgage law, of equitable restitution which provides for payment of such claims from a current expense fund. Second, it held that *Miltenberger* v. *Logansport Ry.,* 106 U.S. 286 (1882) recognized a principle unique to railroad receiverships, and based upon the public interest in continued operations of bankrupt railroads, which provides for payment of such claims regardless of a current expense fund.[4] The Court's delineation of these principles is the issue on this petition for certiorari.

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[4] The First Circuit said (App. A-38-39):

"The criterion of priority to have intrinsic validity must be found in the nature of the claim and in the nature of the reorganization. If the claim is for a service or supply indispensable to the maintenance and operation of the railroad, and if the railroad continues to operate while in reorganization, the real difficulty is in finding a ground on which a court can fairly deny payment of a pre-reorganization expense claim indistinguishable from current administration expenses that are being paid and indistinguishable from kindred operating expenses that were incurred in the ordinary course of business by the railroad company in the months preceding reorganization and were paid by the railroad before reorganization or were paid thereafter by the trustees as liabilities arising out of the operation of the railroad. . . . No principle marks current expenses paid in ordinary course on the eve of reorganization as preferences, but denial of an equivalent right to priority payment for expenses of the same kind likewise incurred on the eve of reorganization introduces an inequality of treatment that finds no justification either in the principles on which businesses are continued in operation during receivership, or in the mortgagee's lien interest. The desideratum is equality of treatment for the current operating expenses of a railroad enterprise the operations of which have continued

REASONS FOR DENYING THE WRIT

I. THE DECISION BELOW IS NOT IN CONFLICT WITH THE DECISIONS OF THIS COURT BUT, RATHER, GIVES FULL EFFECT TO SUCH DECISIONS AFTER AN EXTENSIVE AND SOPHISTICATED ANALYSIS THEREOF.

The First Circuit's decision is not in conflict with any opinion of this Court. The opinion below contains an exhaustive study of all prior decisions relating to the Six Months Rule. App. A-13-34.

The First Circuit concluded that two quite distinct approaches to the Rule emerge from the cases of this Court. App. A-34-41. The opinion's analysis demonstrates that, contrary to the contention of the petitioners, the principles of equitable restitution derived essentially from nineteenth century mortgage law and underlying *Fosdick* v. *Schall,* 99 U.S. 235 (1878) are not the only source of judicial authority for granting a priority to Six Months creditors. In a second line of cases, traced to *Miltenberger* v. *Logansport Ry.,* 106 U.S. 286 (1882), the First Circuit recognized the distinct development of separate principles of receivership administration unique to the railroad receivership context,

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without interruption of service, revenues and expenses. That equality is readily achieved by recognizing administration expenses as extending backward to the period preceding reorganization to the extent necessary to assure that there is continuity in the payment of indispensable operating expenses without reference to the date the petition is filed so long as the current expenses of the pre-reorganization period that are brought forward for payment conform to the strict standard established for administration expenses of the current operating class, and are not so dated as to forbid the conclusion that they are in fact current. The inequity in treatment arising out of the accidental circumstance of non-payment before the filing of the petition is eliminated."

now preserved in railroad reorganization proceedings by the language of the Bankruptcy Act. This line of cases speaks far more expansively of a need to take such actions as will preserve a transportation system for the public.

The petitioners acknowledge the accuracy of the First Circuit's analysis of the *Fosdick* line of cases. Pet. 17.[5] Thus as to the description of the *Fosdick* line of cases in the opinion below, the petitioners have no basis upon which to assert a conflict with this Court.

As to the second, *Miltenberger,* line of cases recognized by the opinion below, the petitioners assert that they are limited to establishing a necessity of payment rule — an interpretation specifically rejected by the decision below, even though that decision acknowledges the existence of such a rule. App. A-37-38, 45. *Miltenberger* should not be read so narrowly, as the opinion below makes clear, at App. A-36-37:

> "The [*Miltenberger*] Court's rationale excludes the inference that only those creditors are entitled to priority of payment who demand immediate payment as a condition of continuing to supply a service or commodity of which they are monopolists. [Footnote omitted.] The Court was defining the *classes* of claims payment of which was indispensable to the business of the road and which, 'unless the receiver was authorized to provide for them at once, the business of the road would suffer great detriment.' [106 U.S.] at 311. The Court's depiction of the disastrous consequences of failing to pay labor claims — a work stoppage [footnote omitted] — or interline claims — a stoppage of traffic interchange — is directed

[5] This necessary acceptance of the First Circuit's description of one of the two lines of cases is not affected by their objection to the subsidiary determination concerning a particular element in that description, relating to depreciation. The lack of a conflict with decisions of this Court on this separate question is discussed in Part IV, *infra,* at 16-17.

to restricting the class of claims entitled to priority of payment to claims for those goods and services that are indispensable to the continued performance of the transportation service. The point is to single out the pre-receivership expenses the payment of which although it — *prima facie* — may stand on a different principle from that governing payment of administrative expenses, 'may be brought within the principle of the latter by special circumstances.' *Ibid.* The test is not whether the claimant has the naked power to exert economic duress, but whether the expenses have the characteristics of those that the receiver pays from revenue as expenses of administration or pays out of the proceeds of the sale of first lien receiver's certificates."[6]

Nor do the petitioners gain any support from this Court's opinion in *Gregg* v. *Metropolitan Trust Co.*, 197 U.S. 183 (1905). Concerning that case, the First Circuit said the following at App. A-37-38:

"Some decisions have, very evidently, read *Gregg* as reducing *Miltenberger* to a Necessity of Payment holding in the starkest economic duress form, [footnote omitted] but *Gregg* is, rather, circumspect in its treatment of *Miltenberger;* it preserves the ambiguity of the *Miltenberger* language without explaining or applying it, and declines to find that Gregg's facts presented special circumstances warranting priority. The Supreme Court has since cited *Miltenberger* for the principle that claims with equities superior to the mortgagee's 'may be accorded priority in payment although they arose prior to

[6] To limit the *Miltenberger* equitable doctrine to a case protecting only those creditors who threaten to cut off essential supplies to a railroad would subvert the very essence of the case. Moreover, it would leave connecting carriers, like the respondents, who must furnish goods and services under statutory and regulatory mandate, helpless. Even if they had the economic power to exercise duress, they cannot lawfully do so. To deprive them of their *Miltenberger* remedy would result, under such circumstances, in an unconstitutional taking of their property. See Petition for a Writ of Certiorari filed by the Chesapeake and Ohio Railway Company *et al.* in No. 80-1196.

the receivership.' *Carpenter* v. *Wabash Ry.*, 309 U.S. 23, 28 (1940)."

The careful language and exhaustive study evident in the First Circuit's opinion represent a discerning and accurate statement of the principles which support the Six Months Rule fully consistent with both the *Fosdick* and *Miltenberger* lines of cases in this Court.

II. THE ASSERTED CONFLICT WITH DECISIONS OF OTHER COURTS OF APPEALS IS NOT SUFFICIENTLY CLEAR, DEFINITE, OR WELL DEVELOPED AS TO WARRANT RESOLUTION BY THIS COURT.

The petitioners considerably overstate their case in asserting a conflict among the Courts of Appeals. Pet. 10-17. They point to four Court of Appeals decisions as purportedly giving rise to a conflict, none of which in fact gives rise to a true conflict. It is submitted that any conflict which may be discerned is of insufficient clarity, definiteness and development to merit resolution by this Court. Stern & Gressman, Supreme Court Practice, § 4.4 (5th Ed. 1978).

A. The Second Circuit

The petitioners rely primarily upon *In re New York, N.H. & H. R.R.*, 405 F.2d 50 (2d Cir. 1968) (*"New Haven"*). Pet. 10-15. However, the petitioners are forced to emphasize the District Court opinion, *In re New York, N.H. & H. R.R.*, 278 F. Supp. 592 (D. Conn. 1967), from which they quote at length, because the Court of Appeals decision does not, in fact, present a clear conflict with the decision below.

With respect to the necessity of a current expense fund, the first of the two questions sought to be presented, the petitioners endeavor to create a conflict from the silence of the Second Circuit decision. The First Circuit decision

addressed two distinct lines of cases bearing upon this situation; the Second Circuit addressed only one. That court did not discuss the principles of *Miltenberger* v. *Logansport Ry.*, 106 U.S. 286 (1882), and does not even cite that case. There is nothing in the Second Circuit opinion to indicate that the applicability or even existence of *Miltenberger* or its principles was argued to, or considered by, that Court. Therefore, the existence of a conflict between the Second Circuit decision in *New Haven* and the holdings summarized in the decision below in Part II (E), ¶¶ 1 and 3 (App. A-45-46) is a matter of inference.

It is true that the District Court decision in *New Haven,* in a footnote quoted at Pet. 12-13, appears to read *Miltenberger* strictly as a necessity of payment case. This statement in the District Court seems to have been an academic excursion and not a response to any argument made by unsecured creditor claimants. The Court of Appeals decision does not adopt (or even refer to) this aspect of the District Court decision. It is unclear whether the applicability of *Miltenberger* was presented either in the District Court or in the Court of Appeals.

The Second Circuit decision in *New Haven* addressed only the application of the principles of *Fosdick* v. *Schall*, 99 U.S. 235 (1878). Its statement of *Fosdick's* principles, including the necessity of a current debt fund, 405 F.2d at 51 and 52 (first column), is totally consistent with the decision below. ("However, if payment is claimed under the *Fosdick* principle, the existence of a current debt fund must be demonstrated." App. A-42.) Indeed, the decision below expressly concludes:

> "The *Fosdick* principle of equitable restitution provides for payment of claims for pre-reorganization current operating expenses from and to the extent of the

existence of a current debt fund determined essentially as indicated in *New Haven* . . . ." Pet. A-46, ¶2.[7]

B. The Third Circuit

There is no conflict between the decision below and any decision of the Court of Appeals for the Third Circuit. *Central R.R.* v. *Manufacturers Hanover Trust Co.*, 421 F.2d 604 (3rd Cir. 1970), the only Third Circuit decision relied upon by petitioners, was not a decision upon either of the questions which the petitioners seek to present in this Court. The issue in *Central R.R.* was an entirely different one: whether it was improper to allow the reorganization trustee to draw $408,000 from a bondholders' account to pay for the removal of the damaged portion of a drawbridge without imposing some obligation upon the reorganization trustee to repay the compulsorily loaned funds to the bondholders' account.

The statements from a footnote in *Central R.R.*, 421 F.2d at 608, n. 13, quoted by petitioners (Pet. 15-16) and approving as a general matter the District Court discussion in *New Haven, supra,* of general principles of law regarding creditor priority, are dicta. Dictum is not a proper basis upon which to predicate a conflict between Courts of Appeals.

C. The Seventh Circuit

The petitioners contend that a conflict exists between the decision below and *Carbon Fuel Co.* v. *Chicago C. & L. R.R.*, 202 F. 172 (7th Cir. 1912). However, that case is not of

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[7] To this conclusion the First Circuit drew one exception concerning the treatment of depreciation, which is the second question sought to be presented by the petition. The ephemeral nature of the asserted conflict on this issue is explained in Part IV, *infra*, to which the entire discussion on depreciation is reserved. See pp. 17-18 *infra*.

sufficient vitality to give rise to a conflict. Only four other cases have ever cited *Carbon Fuel.* Of these, only *Southern Ry.* v. *Flournoy,* 301 F.2d 847 (4th Cir. 1962), which is discussed below, postdated 1918; and the *Flournoy* court obviously felt that *Carbon Fuel* was not inconsistent with its decision. See 301 F.2d at 852-53. See also App. A-24-34.

D. The Fourth Circuit

The petitioners cite *Southern Ry.* v. *Flournoy,* 301 F.2d 847 (4th Cir. 1962), but they do not suggest that this decision is in conflict either with the decision below or with any other decision of any Court of Appeals. Pet. 17. Rather, they assert that *Flournoy* is contrary to this Court's decision in *Gregg* v. *Metropolitan Trust Co.,* 197 U.S. 183 (1905). Even were this the case (which is denied), that would be no reason to grant this petition. See also pp. 7-8, *supra.*

III. THE DECISION OF THE COURT OF APPEALS DOES NOT CONFLICT WITH CONGRESSIONAL POLICY.

The Six Months Rule is of ancient vintage and, since it grants a priority which would have topped mortgages if a receiver in equity had been appointed on the day the petition was approved, it is preserved by Section 77(b) of the Bankruptcy Act. 11 U.S.C. § 205(b) (1976).[8] The Bankruptcy Reform Act of 1978, Pub. L. 95-598, 92 Stat. 2549, while changing the language of this provision only slightly and not substantively (Pet. 2-3, n. 1), continues to recognize

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[8] That section reads, in pertinent part:

"For all purposes of this section unsecured claims, which would have been entitled to priority if a receiver in equity of the property of the debtor had been appointed by a Federal court on the day of the approval of the petition, shall be entitled to such priority and the holders of such claims shall be treated as a separate class or classes of creditors."

the priority for bankruptcies governed by the new statute. 11 U.S.C. § 1171(b) (1979 Supp.).

Petitioners contend, however, that the failure of Congress in 1978 to make any substantive change in the statute demonstrates that the First Circuit was wrong in its interpretation of the old cases establishing the priority, even though those cases antedate both versions of the statute.

The petitioners' description of the legislative history of the Bankruptcy Reform Act of 1978 is erroneous. The Commission on the Bankruptcy Laws of the United States did not believe it was recommending any change in existing law by the proposed provision quoted at the top of Pet. 27 (§ 9-503(d)(3) of the proposed Act). To the contrary, the Commission specifically stated:

> "Section 9-503(d) *retains* the so-called six-month priority rule according creditors who supplied necessities to the debtor within six months prior to the filing of the petition the status of administrative expense claimants." (emphasis added)

Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, 93rd Cong., 1st Sess., Part I, p. 270 (1973). (It is worthy of note that this Commission of experts did not make any reference to a need for a current expense fund in its statement of the rule.)

The original version of S. 2266, 95th Cong., 2d Sess., did not contain any provision for Six Months priority, but when the bill was reported out of Committee it provided as follows:

> "§ 1173. Confirmation of plan
>
> (a) The Court shall approve a plan if it finds that —
>
> . . .

> (9) The plan provides for payment in cash of all al-allowed claims for current operating expenses (including by the debtors) during the six months immediately preceding the filing of the petition in bankruptcy."

Here again, petitioners are wrong in stating that this was believed to be an attempt to change the law. The Committee Report, quoted at Pet. 27, clearly states that this requirement simply "provides the priority *traditionally accorded* by Section 77(b) . . . ." S. Rep. No. 95-989, 95th Cong., 2d Sess. 136, reproduced in [1978] U.S.C.C.A.N., 95th Cong., 2d Sess. at 5922 (emphasis added).

There is no indication in the legislative history that the choice of the language concerning priorities as set forth in the House bill was intended as a rejection of an attempt to broaden the Six Months Rule. In the final debates, the statement is made matter-of-factly that "Section 1171 of the House amendment is derived from section 1170 of the House bill in lieu of section 1173(a)(9) of the Senate amendment." 124 Cong. Rec. H. 11106 (daily ed. Sept. 28, 1978) (remarks of Mr. Edwards) (reprinted in *Collier on Bankruptcy* App. Vol. 3 (15th ed. 1980) at IX-120); 124 Cong. Rec. S. 17422 (daily ed. Oct. 6, 1978) (remarks of Mr. DeConcini) (reprinted in *Collier on Bankruptcy* App. Vol. 3 (15th ed. 1980) at X-46). Reaffirmation of long-standing statutory language hardly demonstrates any implicit antipathy of Congress to the Six Months Rule, and certainly cannot be read to overrule *Miltenberger* v. *Logansport Ry.*, 106 U.S. 286 (1882). Accordingly, if the First Circuit is correct in its interpretation of *Miltenberger* — as clearly it is — it is not in conflict with any imagined Congressional policy on the subject, since Congress reenacted the old statute which had first been enacted after, and in light of, *Miltenberger*.

IV. THE SECOND QUESTION PRESENTED, CONCERNING THE TREATMENT OF DEPRECIATION, IS NOT WORTHY OF REVIEW.

A. The Court of Appeals was correct in refusing to deduct depreciation from revenue in determining the existence of a current expense fund.

The existence *vel non* of a "current expense fund" is an issue only with respect to the *Fosdick* principle, and not the *Miltenberger* principle. In analyzing the application of *Fosdick,* the Court of Appeals held that depreciation is not deductible in determining the existence of the current debt fund. App. A-42-45.

As pointed out by the First Circuit, the current debt fund, properly considered, is composed of *current* operating revenues less *current* operating expenses. A charge to depreciation is not an expense, either current or operating. It is strictly an accounting entry. The debtor is not obligated to make payment out of its funds as with true expenses. There is no transfer of funds and no one to whom a transfer can be made. Whatever funds are otherwise available to the debtor are unaffected by the bookkeeping entry so labelled.

The Court of Appeals said, after consideration of the same arguments that petitioners are now making:

> "Certainly the depreciation of income producing property, the exhaustion of its utility over the years of its useful life, is an objective fact. It is, however, not related to ordinary repair and maintenance; it relates to the exhaustion of useful life despite regular repairs and maintenance. Depreciation is by its nature indelibly a capital charge, the cost, allocated to the accounting period, of the capital used to produce the revenue of that period. If the depreciation reserve is considered an accumulating fund, and not simply a record of the annual

postings of fractions of the original capital cost, it is a fund accumulated to restore the original capital investment in money, or to provide a new capital asset. But the annual charges to revenue for depreciation of capital assets do not create a fund in specie that preserves the identity and stands in place of the depreciable asset and is subject to any mortgage that there may be on the asset. There is no suggestion that, here, the railroad did, or that, generally, railroads do undertake with their mortgage bondholders that they will use an amount equal to annual depreciation to make good — if that could be done — the physical depreciation of the mortgaged property. Something roughly like that may no doubt occur in good times as a portion of earnings each year is reinvested in the road, but such reinvestments are capital outlay for new assets themselves depreciable, and that the new investments may not exceed the depreciation charges of the same period means only that — assuming constant prices — the road is losing old capital values through use faster than it is acquiring new capital assets. In good times new capital assets acquired will often, perhaps usually, come under the after-acquired property clauses of the mortgage, and the long term mortgagee will have a kind of slowly revolving security. But first to last depreciation is related to capital, its exhaustion, and its replacement, not to its maintenance, and it is not an expenditure that affects cash flow of the accounting period." App. A-42-44 (footnotes omitted).

The determination of the current debt fund is primarily a cash flow question. If the cash is available, it is to be used to benefit the creditors who qualify, not set aside for such future capital expenditure which will only benefit either those who hold a lien on such after-acquired property or, possibly, future stockholders.

". . . Since the six-months creditor must rely upon the railroad's short-term ability to pay its current debts, the reduction of the current expense fund by a noncash item such as depreciation, which does not directly impair the railroad's short-term cash or current receipts position, is improper."

Note, *Bankruptcy Law—The Continued Vitality of the Six-Months Rule in Railroad Receiverships,* 57 N.C.L. Rev. 137, 146 (1978).

B. The decision below is fully consistent with the decisions of this Court, none of which has ever allowed a depreciation deduction.

The very statement of the rule in *Fosdick* demonstrates the cash flow basis of the computation which must be undertaken:

> "Every railroad mortgagee in accepting his security impliedly agrees that the *current debts* made in the ordinary course of business shall be paid from the *current receipts* before he has any claim upon the income." (emphasis added)

99 U.S. at 252. The Court did not say that pre-reorganization supplies of items necessary for the operation of the road could only be paid from gross operating revenue less depreciation (or even from net operating revenue less depreciation).

No decision of this Court has ever allowed a deduction for depreciation or its equivalent in the computation of a current expense fund under *Fosdick* principles. *Southern Ry.* v. *Carnegie Steel Co.,* 176 U.S. 257 (1900) is illustrative. Among the disbursements during the receivership in that case were substantial payments to a sinking fund, a device which performs a function analogous to depreciation in diverting current revenues for the benefit of long-term creditors. The Court held that the *Fosdick* claims were entitled to priority with respect to net earnings from which the amounts disbursed to this sinking fund should not be deducted. 176 U.S. at 294-97. Any deduction for depreciation equally should be viewed as a diversion to the mortgagees and, therefore, under *Fosdick* depreciation should

not be subtracted from revenues in ascertaining the existence or amount of a current expense fund. The First Circuit's conclusion that the deduction of depreciation charges was improper in calculating the income component of the current expense fund was fully consistent with the prior cases of this Court.

C. The asserted conflict with other Courts of Appeals is ephemeral.

The petitioners assert that with respect to the deduction of depreciation in determining the existence of a current debt fund under *Fosdick,* there is a conflict between the decision below and the Second Circuit decision in *New Haven, supra.* This discrepancy was noted by the First Circuit, where, after otherwise accepting the *New Haven* determination of the fund, that Court continued:

> ". . . except that depreciation is not deductible in determining the amount of the income component of the current debt fund." App. A-46, ¶ 2.

This conflict, however, is superficial only, and this issue in particular is not appropriately presented for resolution by this Court. No other Court of Appeals decision has ever even alluded to a deduction for depreciation in the context of determining the existence or amount of a current debt fund under *Fosdick.* Moreover, the *New Haven* decision itself was not directed to this issue, but instead to the broader issue of whether *any* deductions should be made for current liabilities in determining the existence of a current expense fund. 405 F.2d at 52 (second column). The court held that "operating expenses and depreciation" should be so deducted, *id.,* but there is no discussion of depreciation as a separate or specific issue; it is just lumped in. Even if this result were correct (which is denied), the

New Haven conclusion on depreciation can hardly be called a definitive statement. The discussion of the treatment of depreciation in the decision below (Part II (C), App. A-41-45), is the first considered exploration of this issue by any Court of Appeals.

Moreover, the District Court opinion in *New Haven* made it clear that once operating expenses were deducted from operating revenues in that case, no fund existed regardless of the treatment of depreciation. See 278 F.Supp. at 600-07. Thus, the Second Circuit's reference to depreciation was dictum.[9]

Indeed, the materiality of this issue is not clear in this case either. If the holdings of the decision below with respect to *Miltenberger* principles are not reversed, then the determination of a current debt fund under *Fosdick* will not be necessary, and hence the treatment of depreciation will not have to be addressed. Moreover, it is not entirely clear whether disallowing the depreciation deduction for purposes of calculating the existence and amount of a current debt fund under *Fosdick* principles would have any effect, as a practical matter. The petition asserts that in this case "there is a deficit in net railway operating income apart from the depreciation charge." Pet. 9. If this is true, and if the situation continues until the time of reorganization in this case, then the treatment of depreciation may be moot.

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[9] A district court located within the Third Circuit has, as petitioners assert, followed the *New Haven* approach and deducted depreciation in the determination of a current debt fund under *Fosdick*. *In re Penn Central Transp. Co.*, 458 F.Supp. 1234, 1321-24 (E.D. Pa. 1978). However, here again the treatment of depreciation was without discussion and was irrelevant to the result. 458 F.Supp. at 1325. No appeal was taken.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be denied.

Respectfully submitted,

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